# DOW THEORY LETTERS INC.

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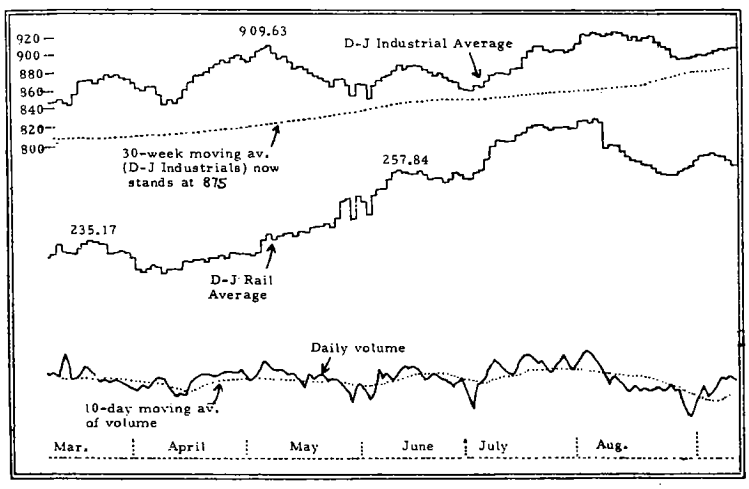
THE MARKET: According to Dow Theory, reliable inferences may be drawn through the action of the Averages as they confirm each other by penetrating preceding high or low points. Dow's Theory further stipulates that we consider only the action of both Averages. The movement of a single action, unconfirmed by the other, may be unreliable or even highly deceptive.

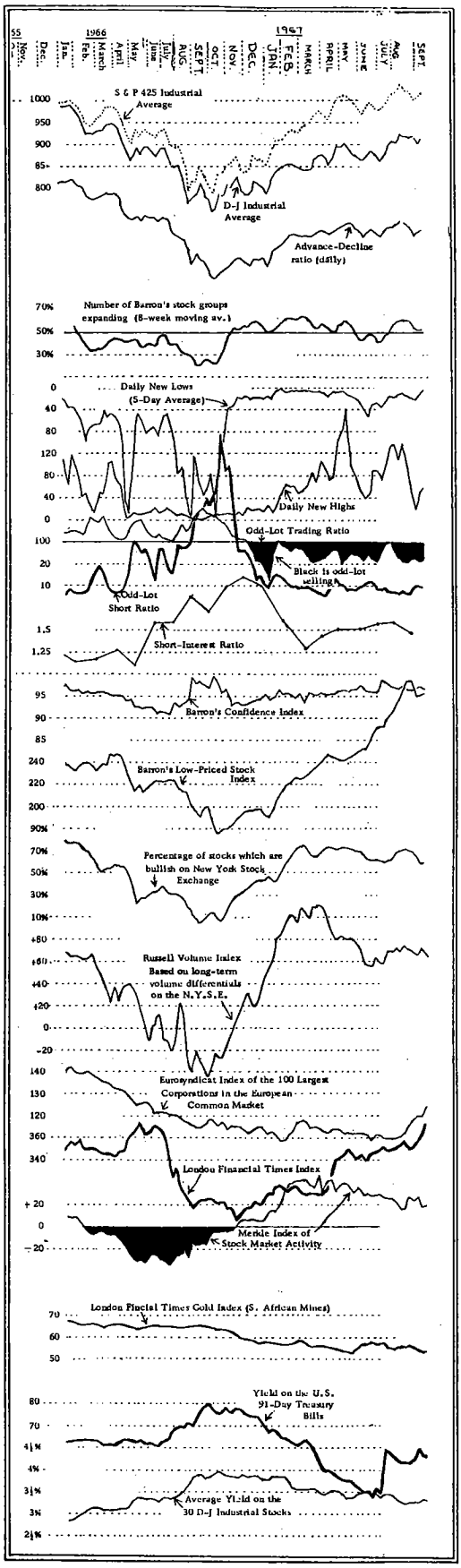
On August 9 the Industrial Average rose to a 1967 recovery high of 926.72. A few days earlier (August 4) the Rail Average had recorded a recovery high of 274.49. On August 8, Chicago North Western (which is in the Rail Average) called off its merger with Essex Wire, and this resulted in a huge downside "gap" of 5.76 points in the Rail index. The entire market seemed to be affected by the sudden Rail break, and over the next few weeks stocks drifted lower.

In late August decline lows of 893.72 for Industrials and 256.06 for Rails were established. Thus we now have two important series of "check levels," the 926.72 and 274.49 highs of early August and the 893.72 and 256.06 lows of late-August. Joint penetration of either one of these two sets of levels should create the impetus for the next major market trend.

Aside from the pattern of the Averages themselves, a second consideration at this juncture is the relationship between price (the Industrial Average) and breadth (the advance-decline ratio). I have included a chart on page 2 which traces the action of the D-J Industrials and the advance-decline ratio over the past few months. Note points 1 and 2 of early August. At point 2 the A-D ratio failed fractionally to confirm the new high in the Industrial Average. Weakness ensued immediately and a three-week decline followed. The latest rally started on August 31, and as stated in the last Letter, Industrials now seem ready to test their August highs. The important question, however, is whether the A-D ratio will again fail to confirm. My guess is that any new high in Industrials (above 926.72) will be unconfirmed by the A-D ratio, and that this will bring trouble immediately. We will therefore watch the action of Industrials and the A-D ratio most carefully during the period ahead.

One of the fantastic characteristics of this market is the seeming inability, regardless of many danger signals, of Wall Street to stir up any sustained selling interest. In my opinion, this reflects utter disbelief on the part of the public regarding the possibility of trouble ahead. The man-on-the-street has been bombarded with talk about inflation, paper gold, what Washington can do and what LBJ wants for





1966
1967
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline ratio (daily)
Number of Barron's stock groups expanding (8-week moving av.)
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-Lot Short Ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of stocks which are bullish on New York Stock Exchange
Russell Volume Index Based on long-term volume differentials on the N.Y.S.E.
Eurosyndicat Index of the 100 Largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
London Fincial Times Gold Index (S. African Mines)
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks

so long that he is almost "scare proof." Nothing shakes him anymore; he does not budge in the face of rocketing interest rates, the Egyptian-Israeli conflict, the near-bombing of China, a massive auto strike. All will be well, thinks the "totally conditioned" investor of 1967, and why sell stocks under any situation short of nuclear annihilation? In case of nuclear conflict, it would not matter anyway, so why worry?

As far as speculation goes, Wall Street has seen it in spades during 1967. This year, according to late N.Y.S.E. statistics, 60,000 new margin accounts have been opened in 1967, and the latest margin tabulation puts total debit loans (margins) at $5.58 billion, thus, the number of margin accounts and the sheer amount of margin outstanding has now risen to historic highs. Everybody wants to be "in the game," and there are more people willing to gamble on margin than ever before in history.

BRITAIN: With a great blast of headlines (such as this one from the popular Daily Express), Prime Minister Harold Wilson announced that he was assuming all responsibility for Britain's economic affairs.

This was simply another way of saying that Britain was going on the inflation bandwagon again. Unemployment in Britain has soared to 559 thousand, highest since the 1940's. It is a figure that Wilson says is "unacceptable" for a labor government, and of course as a typical New Economist, Mr. Wilson is ready to try anything which will bring him votes rather than sneers.

Somehow, the whole "I'll run the economy" line of Wilson's reminds me of Roosevelt's boast of the 1930's regarding the pickup in the economy following the 1932-33 collapse "We planned it that way," announced Roosevelt. A few years later, during 1937-38, after the stock market and business had caved in, Roosevelt was taunted with his "We planned it that way" bravado. But he remained strangely silent in 1938 regarding his economic prowess. The writer wonders if Mr. Wilson won't have occasion during the next year or so to regret his own economic boasts.

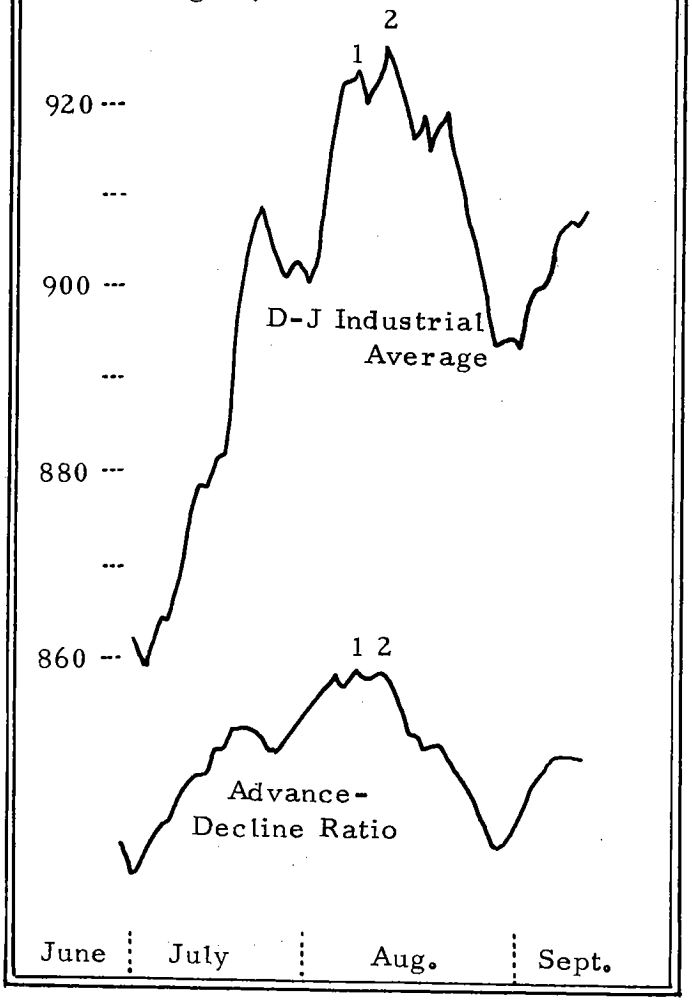
Back of this speculative intensity, this willingness to hold shares regardless of the seriousness of coming events, is the spector of Washington's greed. With an election coming up, with America's most unpopular war in progress, with a poison-personality President, this Administration will stop at nothing to keep its most treasured "baby," the boom-economy, rolling. If inflation is needed, if the value of savings, insurance policies and pensions is to be wiped out, why, let them be wiped out, says this Administration. Votes are what counts, and if inflation can keep the boom going, this Administration is willing to issue paper dollars, to do away with gold, to put 25% of the nation on public payrolls. In short, they are willing to stop at nothing to avoid upsetting the apple cart during 1967-68.

In an article in September 6's Christian Science Monitor, P. McKinsey states, "There is mounting concern at the White House and at the Federal Reserve as well, over the rash of price hikes. But there is also considerable doubt among Washington economic observers that either camp can do much now to hold down prices.

"Certainly the Administration's futile attempts to check the advance in steel bar prices doesn't do much to put these doubts to rest. Now, as some in Washington see it, the White House—having lost, and lost badly, in its bout with the steel industry—will think twice about challenging other price hikes in the future." And so it goes.

Bond holders, owners of a large chunk of the outstanding debt of the nation, have reason to distrust everything this Administration is doing. Little wonder the Aa rated bonds are now yielding over

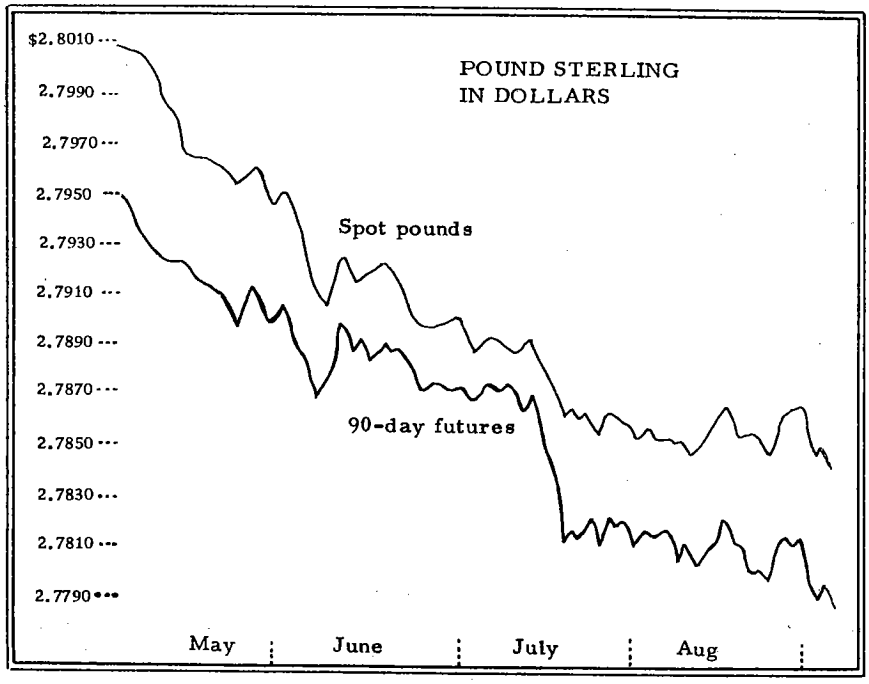
(See Page 1)



6%, with many bond syndicates breaking up before they can retail their wares. On September 5 the broadly representative D-J 40-Bond Average broke to another 33 year low, 79.23. Since this index was 84.40 in January, 1967, it can be seen that the erosion in the usually slow-moving bonds has been disastrous. The Average yield on the 40-Bond Average is now over 6%. When one considers the 3.36% yield afforded by the D-J Industrial Average, the case for holding common stocks becomes almost an absurdity. Yields on the Dow Industrials would have to almost double to match bond yields, and this after the longest period of economic expansion and inflation in American history. It is this kind of reasoning which makes me certain that we are now in an area of mass distribution of stocks, distribution from informed hands to the crowd.

When will the dam break, that is the question. In his latest Stock Market Credit Analysis report, Dr. Sloan Wilson states the following: "Market peaks accompanied by record volume of trade shares and margin accounts have been followed by declines of not less than 25% in the D-J Industrial Average." There is no question regarding the recent record volume and record margin balances outstanding. The only question is when the time of reckoning begins.

From the standpoint of timing, the trouble could start any time this fall—or it could, perhaps be put off into the winter. But readers should remember (see last Letter) that historically, the months of September through December have produced some of the worst cracks in stock market annals. The background for trouble is evident all about us, the shakiness of the pound sterling, the mounting U.S. budget deficit, the war in Vietnam, the coming surtax, the social unrest, the shrinking corporate profits, the dangerous speculation, the sagging utility and bond markets. I could go on and on with this listing, but one fact is apparent to me. The game is not worth the candle anymore. The "safe" profits have been made, and the informed investors are moving to the exits.



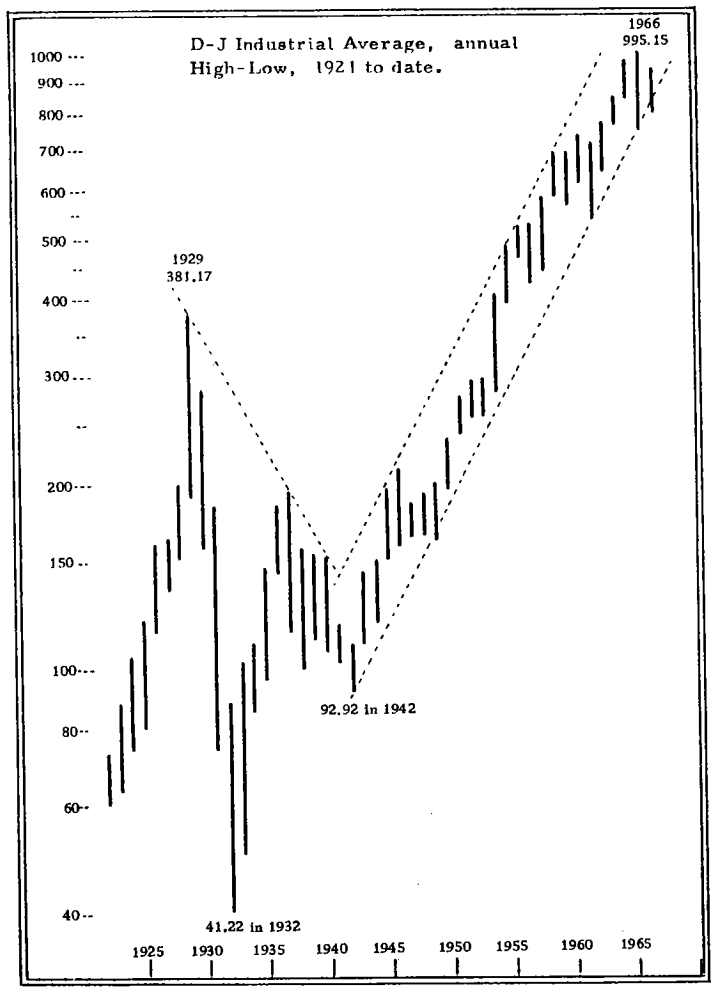

GOLDS: Last week golds sold off sharply in response to the news that "the U.S. had won a round in its struggle to force the world to accept 'paper gold'." Leading U.S. officials (in the face of new gold losses for July) talked ecstatically about "the greatest forward step in monetary reform in two decades."

What they did not talk about was the fact that the "reforms" were merely increased drawing rights for the member nations of the International Monetary Fund. The plan for the Special Drawing Rights (SDR's), however, must be written in as a supplement to the 1946 Bretton Woods pact, and it must then be ratified by 85% of the I.M.F. members. It is expected that the European Economic Community (lead by France) will put in one rather severe (to say the least) stipulation before ratifying the measure. They will insist that the new SDR's will not go into effect until the U.S. cuts its budget deficit down to $1 billion per year. This is tantamount to telling a heavy spender that he can borrow more money as soon as he stops spending. Furthermore, the Drawing Rights are not to go into effect until 1969, two pressure-filled years away.

The immediate reaction to the new formulation was a sell-off in gold and a little rally in the British pound sterling. This observer, being rather skeptical, likes to keep charts for the simple reason that prices are always less emotional than the published news. Therefore, imagine my surprise when following the little rally the spot price (or current price) of the pound and the 90-day future price both broke to new lows for 1967. Evidently, the possibility of 1969 Special Drawing Rights have not impressed those who trade and speculate on the pound's future. In the face of the renewed weakness in the pound, the golds rallied last week. In my opinion, the pound and the dollar are far from being "out of the woods," (no pun on Bretton Woods intended), and the story is still unfolding.

FORTY-FIVE YEARS: I presented the yearly high-low chart early last year, and I want, at this time, to bring this study up to date. This most interesting chart (semi-log or ratio scale) shows the annual high and low for the Dow since 1922.

Robert Rhea, the famous Dow Theorist, stated that he had never been able to incorporate trendlines into Dow's Theory, and I agree with him. However, even a casual study of this chart must cause one to ponder the current position of the Industrials.




The fact is that the Dow has been rising within the confines of a twenty-six year channel, a channel bordered by two amazing ascending trendlines (dotted lines on chart). This channel constitutes one of the longest intact trends in financial history.

The year 1966 saw the extreme closings of the Dow at 995.14 and 744.32. We note on the chart that the 1966 low held just within the confines of the lower trendline. For the year 1967 I calculate the lower trendline to intersect at around 800. The early January, 1967 figure for the Industrials was 785, and thus the 1967 opening did cut slightly below the lower trendline. However, when one is dealing with a chart of this magnitude, I feel that 15 points is not enough to provide a significant penetration. Furthermore, the penetration was a quirk of the calendar in that the year 1967 opened with the Dow climbing but slightly below the lower trendline.

It is obvious that any real weakness from here on, any weakness which carried that Dow substantially below the 785 level, would constitute the first penetration of the major upward trend in its twenty-six year history. Furthermore, any weakness which carries the Dow down into the 800 area in early 1968 would certainly take the senior Average outside the ascending channel. Thus, readers can see how important the continuance of strength is for this market. From a trend standpoint, the Industrials are now flirting with the edge. They cannot afford any weakenss now or during 1968, at least as far as those who believe in the importance of holding a twenty-six year trend intact are concerned.

LATE NOTES: I want to draw subscribers' attentions to the Russell long-term Volume Index as shown on the composite chart on page 1. This Index (based on the difference between upside and downside volume) has been excellent in gauging both the "strength" of the market and the direction of forthcoming trends.

Last week the Russell Volume Index took a large drop— from 74 the week before to 65 last week. The figure 65 represents the lowest point on the Index since the 59 registered for the last week in June. At best, I would say that the Index is calling for a sideways movement for the market over coming weeks. At worst, I feel that it could represent the beginning of important weakness. The real peril point on the Russell Index is the 56 recorded during the week ending June 8. Any break below the 56 point would amost surely spell major trouble ahead.

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It is rather remarkable to note how many of the indices on the page 1 composite chart are now moving sideways. These include the advance-decline ratio, the odd-lot ratio, Barron's Confidence Index, the Percentage of N.Y.S.E. stocks which are bullish, the Merkle Index and the yields on Treasury bills. Like most other things in the market, the longer a trend holds intact, the nearer it is to the next major change. I would guess that we are getting close to some sort of important change (in volume, intensity, activity, direction) in the market.